

N.D.A.G. Letter to Satrom (Oct. 2, 1986)

October 2, 1986

Ms. Katherine Satrom
Chairman
Workmen's Compensation Bureau
Russel Building
4007 North State Street
Bismarck, ND 58501

Dear Ms. Satrom:

Thank you for your letter of August 28, 1986, and the supplemental memorandum of September 2, 1986, concerning securities lending by Northern Trust of Chicago, the custodian of the Workmen's Compensation Bureau's assets. Specifically, you inquired whether Section 3 of the proposed agreement between the State Investment Board and Northern Trust is lawful.

Section 3 of the proposed agreement indicates that the State Investment Board may appoint Northern Trust as a lending fiduciary whereupon it may lend securities of Workmen's Compensation to brokerage firms. Section 3 further provides that "the market value of the loan securities shall be collateralized with direct obligations of the U.S. Government - Bond - Notes - Bills or Agencies of U.S. Government in the amount of 102 percent marked to market weekly or daily if requested by lender."

The 1976 Attorney General's Opinion to which you referred in your letter was invalidated by the 1977 Legislative Assembly in an amendment to N.D.C.C. § 21-10-02. N.D.C.C. § 21-10-02 provides that "the [State Investment] board may authorize the investment director [Northern Trust] to lend securities held by the funds." Section 21-10-02 further provides that "the securities must be collateralized by direct or guaranteed obligations of the United States government." It is my opinion that Section 3 of the proposed contract conforms with the requirements of N.D.C.C. § 21-10-02.

Although securities lending pursuant to N.D.C.C. § 21-10-02 is permissible, Northern Trust has advised this office that the restrictive collateral requirements of N.D.C.C. § 21-10-02 (Government Securities) will severely limit its ability to negotiate transactions with brokerage firms.

Northern Trust implements an automated system for securities lending that allows brokerage firms to borrow securities by pledging any combination of the following three types of collateral: cash, letters of credit, and government securities.

N.D.C.C. § 21-10-02 expressly requires that any securities lent by a custodian be collateralized by government obligations. Inasmuch as the underlying value for a

government obligation is the dollar, cash must also be considered as an acceptable form of collateral under N.D.C.C. § 21-10-02. Letters of credit, however, cannot be construed as acceptable collateral for securities lending purposes.

Unless Northern Trust is able to change its automated system or is willing to manually override the system, securities lending by Northern Trust is probably not a viable alternative for any of the funds under the State Investment Board at the present time. However, I understand that legislation is being proposed that will enable the State Investment Board to take advantage of securities lending without the restrictive collateral requirement of N.D.C.C. § 21-10-02.

You also requested that I provide any additional comments that I might have concerning the proposed contract. The review process of this office does not reveal any legal deficiencies in the proposed contract. The substance of the contract, however, should be carefully reviewed by the Investment Board prior to execution.

If you have any further questions please do not hesitate to contact me.

Sincerely,

Nicholas J. Spaeth

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